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November 25, 1996

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 20554

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Federal Communications Commission
Office of Secretary

Re: Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the
Communications Act of 1934, as amended; and Regulatory Treatment of LEC
Provision of Interexchange Services Originating in the LEC's Local Exchange Area,
CC Docket No. 96-149

Dear Mr. Caton:

On Friday, November 22, 1996, Tony Epstein and I met with Suzanne Tetreault and Debra Weiner. The purpose of the meeting was to review MCI's position in this proceeding as stated in MCI's comments. The attached documents were used during the meeting and outline the topics discussed.

Due to the late hour of the meeting two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's rules the next business day.

Sincerely,

Kimberly M. Kirby

cc: Suzanne Tetreault
Debra Weiner

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Sections 271(e)(1) and 272(g)

The focus of Section 272, and this rulemaking, is the requirements for BOC separate affiliates and the competitive safeguards necessary in order to ensure that the BOCs do not abuse their market power. The focus of Section 271(e)(1) is to prevent, for a limited time, one category of interexchange carriers from certain marketing practices relating to BOC local services that they have a right to resell on an unseparated basis. The two sections serve very different purposes. They are not intended to be interchangeable nor should they be interpreted as such.

Thus the Commission's focus in this proceeding should be that competitive safeguards for BOC affiliates are necessary in order to prevent the abuse of market power. The 1996 Act recognizes the BOCs' continuing local market power in a myriad of ways, including stringent conditions that must be satisfied before granting in-region authority as well as the separation and other requirements of section 272. These requirements, which are imposed on the BOCs, not the IXCs, are a legislative recognition that the marketplace already restricts the IXCs with respect to market power and therefore the BOCs require greater restrictions in order to create a "truly" level playing field. The legislature did not similarly restrict the IXCs and other new entrants. Sections 271(e)(1) and 272(g) should be interpreted in a manner that recognizes the vast differences in market power.

While MCI and other new entrants may have name recognition in the long distance market, the BOCs have a business relationship with every single residential and business customer in its region and at least equal name recognition due to advertising paid by captive ratepayers, including interexchange carriers. MCI must overcome that 100 percent market disadvantage and will not be able to do so if regulated to the same degree, or even similarly, as the BOC affiliate. That is why the act does not require MCI or any other interexchange carrier to provide any local services on a separated basis, including resold BOC services. The restrictions that the BOCs would impose on the large IXCs prior to the BOCs' obtaining in-region authority (i.e., separate sales channels for local and long distance services), would create a de facto separation requirement for IXCs, which is directly contrary to the language, intent, and structure of the 1996 Act.



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Noncompliance With Section 272

There are indications that the BOCs are already building in-region LD facilities and engaging in other preparatory activities in anticipation of in-region LD authority. For example, a September 23, 1996 Telecommunications Reports article quotes Alfred Binford, Chief Executive Officer of Bell Atlantic Communications, Inc. (the long distance unit) as stating that Bell Atlantic intends to complete its in-region LD network in 1997, about when it expects to receive in-region authority, which means that work is well underway by now. See attachment.

There are no indications that these ongoing activities are being carried out in conformance with the separation requirements of Section 272, which requires total physical and operational separation between a BOC's local and in-region LD activities. Thus, local and access ratepayers may well be funding these LD activities through the application of the local service entity's resources.

It makes no difference that the BOCs have not yet actually started to provide in-region LD service and that once they do start, they will be required to provide such services only through separate affiliates in accordance with the rules established in CC Docket No. 96-149. If ratepayers are funding any part of these in-region LD activities, or if the BOC's local service entity is contributing any personnel or other resources to such activities, massive cross-subsidies and discrimination will have already taken place before a BOC receives in-region authority. At that point, the costs associated with building in-region interLATA facilities will be intermingled with local exchange costs in the BOCs' regulated accounting system. The addition of these improper costs to local exchange activities will have the effect of depressing earnings on services that are today rate regulated or price capped in the intrastate and interstate jurisdictions. Since the vast majority of price cap or incentive-based regulatory plans are linked to BOC earnings, the addition of costs as substantial as those required for construction of an interLATA network will have the effect of causing ratepayers to subsidize their construction. Moreover, the participation of the BOC's local exchange entity or contribution of any of its expertise or other resources to such construction would result in discrimination, since the BOC LD operation would receive a benefit available to no other entity. Thus, the purposes of Section 272(b) will have been sabotaged in advance.

Accordingly, the Commission needs to take prophylactic action now, in order to prevent any further harm from the mingling of local and in-region LD resources by the BOCs. First, the Commission should require the BOCs to cease and desist from all further in-region LD construction and other preparation activities until final separation rules can be established in CC Docket No. 96-149. Second, the Commission should require the BOCs to provide detailed financial reports of all activities to date relating in any way to such activities immediately, including the identification of whether plant constructed to date is LD or was installed to upgrade the local network, and capitalized engineering costs, which reports should be made available to the public. Third, once separation rules are established in CC Docket No. 96-149, and the BOCs set up separate LD affiliates in conformance with such rules, such affiliates should be required to reimburse the BOCs' local service entities for the resources provided to the LD preparation efforts prior to the cease and desist order. Such charges should also be reflected in any imputation analysis in reviewing whether a BOC's in-region LD services cover all of their costs.

Bells, GTE Lay Out Marketing Strategies, Swap Success Stories at New York Conference

For what may be the last time ever, the seven Bell regional holding companies (RHCs) and GTE Corp. got together last week to discuss their strategies for maintaining local exchange market share while gaining long distance customers. While the tenor of the conference was congenial, speakers were very aware that others in the room soon will be their competitors.

But at least for now, the RHCs remain united against a common enemy: the interexchange carriers that want to lure away local exchange customers. "We've got a lot more in common right now than we have differences. We can all help each other by being successful," one Bell company executive told *TR*. "When one is successful, we're all successful." The challenge for the RHCs is clear: They must compete and win in their core local exchange service markets if they are to survive. And, like most other telecom service providers, they are seeking to become "all-in-one" providers of local exchange, local toll, long distance, wireless, and video services.

HIGHLIGHTS: Bell companies say common goals outweigh differences, for now. . .Dillon, Reed analysts see strong, "sustained growth" for Bells. . .Target marketing becoming key strategy for attracting, retaining customers.

In opening remarks at the Sept. 18 conference sponsored by investment bankers Dillon, Reed & Co., Inc., in New York, Senior Vice President William D. Vogel said his bullish investment stance on Bell company stocks is based in part on their "aggressive marketing" to position themselves as full-service providers. He noted that the Bells' collective \$21 billion marketing efforts have outpaced those of potential competitors, including AT&T Corp. But advertising budgets notwithstanding, Wall Street apparently remains skeptical that the Bells can make a smooth transition from being monopolists to aggressive marketers. The Bell companies' stock prices have lagged well behind the projections of Mr. Vogel and several other "buy-side" analysts.

But Mr. Vogel addressed industry and financial community naysayers, who point to the interexchange carriers' strong brand identities and national marketing experience as evidence that the Bells may be doomed when competition blossoms in all telecom markets. "Evaluations based on brand name are overly simplistic and reflect a poor understanding of brand strength in the market," he said.

The Dillon, Reed analyst sees a potential for "tremendous sustained growth" among the Bell companies based on the following factors:

- The low penetration rates for value-added services, such as Caller ID;
- The increasing number of new products being introduced by the Bells; and
- The diversity of sales channels they now employ to reach new customers.

That message was not lost on the Bell executives. Recent RHC advertisements, which were a centerpiece of the conference, are aimed at extending the Bells' presence beyond their home markets and traditional product lines. They consistently focus on the same themes: simplicity, technological superiority, and familiarity. But each company also has taken a different tack in approaching—or "re-approaching," according to some executives—current and future customers.

GTE Promises To 'Help' Customers

GTE Telephone Operations, for example, predicates its new advertising campaign on the premise that consumers are "confused" and need help in deciding where to turn for telecom services, according to Clarence F. (Butch) Bercher, President-consumer markets. The company is using the Beatles' tune "Help" in its television advertising.

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BellSouth SET TO NAB MORE 'WIRELESS CABLE' ASSETS

BellSouth Corp. has signed a non-binding letter of intent to buy National Wireless Holdings, Inc.'s MMDS (multichannel multipoint distribution service) assets in the Miami area for \$48 million in stock. The companies said further details aren't available because they still are negotiating a definitive agreement. BellSouth, which recently won the right to operate an MMDS system in New Orleans (TR, June 3), is among Bell companies that have started amassing wireless cable TV assets to facilitate quick entry into video markets. BellSouth also has obtained cable TV franchises in the Atlanta area; Daniel Island, S.C.; Vestavia Hills, Ala., and St. Johns, Fla.

It currently is signing up more than 9,000 long distance customers a day in the 21 states where it offers the service. The company plans to begin interexchange operations in Pennsylvania within a few weeks, he said, and will provide service in all 50 states by year-end.

U S WEST Tries To Leverage 'Localness'

James A. Smith, VP and General Manager-local markets for U S WEST Communications, Inc., might have called his conference presentation "Leveraging Localness." He said U S WEST and all the Bells must be better at segmenting their markets and understanding local customers. "We have an opportunity to have a better understanding of our local customers than the companies entering our markets," he said, noting that targeted marketing is U S WEST's primary strategy for retaining local exchange market share.

Mr. Smith admitted that this marketing approach is new for Bell companies, which "used to view our customers as the public utility commissioners and staffers. It's a new thing for us to be able to address various marketing standpoints," he said. U S WEST was the first RHC to unify its telco operations under a single brand name, U S WEST Communications, Inc. And it was the first to orient its business units to market segments, such as video services, telephone operations, and data networking.

The new marketing orientation also occasioned more fundamental changes at U S WEST, Mr. Smith said. He noted that the telco has replaced most of its senior executives over the last three years. That story was a familiar one to many Bell representatives at the conference, some of whom only a few years ago were working for companies such as AT&T. Mr. Smith, a veteran of the old Bell System, joined Pacific Northwest Bell in 1979 and is one of only two senior managers remaining from the original U S WEST Communications team, he said.

Mr. Smith also aired another familiar (if new-found) anthem among the Bells. "We are becoming more and more rigorous in our cash-flow decision making," he said. In a competitive environment where no company will have a guaranteed income, the Bell companies must "make every marketing dollar count," he said. For example, U S WEST is working to reduce its marketing "cycle time"—the amount of time it takes to mount a response to a competitor's marketing initiative. The key is to respond in "no more than three days," he said.

"We have been network-centric businesses, but that is no longer the case," Mr. Smith said. He noted that at U S WEST, "marketing is becoming first among equals, at least in my opinion." If the Bell companies don't take advantage of the unique characteristics of customers in their regions, they will lose an inherent advantage, he warned.

NYNEX Works To Keep High-Value Customers

Brian R. Lane, Group VP-marketing for NYNEX Corp., noted that his company has somewhat more experience with local competition than other RHCs. But for NYNEX, it is the "globalization" of telecommunications that is driving marketing plans. "New York City is the birthplace of local competition... We're not concerned about opening the local market," he said. NYNEX is looking forward to

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revision of the federal access charge and universal service regimes, hoping these actions will allow it to implement "a more competitive rate structure and take subsidies out" of its local service rates.

The competitive risk arising from the new regulatory landscape is "manageable," according to Mr. Lane. The Bell companies must learn that "you cannot retain 100% of the market profitability. We have to learn how to lose customers profitably." That concept is unfamiliar to monopolists, but NYNEX has learned that lesson through competition in the intraLATA (local access and transport area) toll service market, he said.

Mr. Lane said NYNEX is winning back customers it lost in the intraLATA toll market in New York (calls placed between New York City's five boroughs). New Yorkers can presubscribe to an intraLATA toll carrier as well as an interexchange service carrier. NYNEX has learned lessons about market segmentation. Competitors "are having a hard time finding the high-value customers," he said, noting that NYNEX has been able to retain many small business customers, which typically make a lot of intraLATA toll calls.

The vehicle for NYNEX's success in this market is an optional flat-rate pricing plan. It has signed up 1.7 million subscribers for the plan in the last year. When NYNEX knew the intraLATA toll market would be opened to competition, it was able to pre-position its plan to retain customers, Mr. Lane said. It ran ads that equated competition with confusion and frustration, and it targeted small businesses. The calling plan not only helped customer retention, it also stimulated usage, which helped to offset competitive losses, he reported.

Bell Atlantic Adopts Retail Long Distance Strategy

Alfred G. Binford, President and Chief Executive Officer of Bell Atlantic Communications, Inc. (the RHC's long distance unit), said, "Clearly our intention is to have a strong retail position" in both core and emerging markets. Bell Atlantic believes its new markets (e.g., long distance service) have more "upside" than its core business. For example, customer usage of long distance service "is growing in double digits, unlike local service," he said.

"In the two years it took us to get into long distance, the market grew by \$2 billion. That's \$2 billion more of new operating margin that we can go after," Mr. Binford said. Bell Atlantic expects to carry 25% of in-region long distance calls by the year 2002, he added. Almost 40% of the long distance calls originating in Bell Atlantic's seven states also terminate in those states.

"That's significant from a cost and marketing perspective," he said, adding that about 80% of long distance revenues are generated by residential consumers and small businesses—market segments Bell Atlantic thinks it can win over.

Bell Atlantic currently is leasing Sprint Corp.'s long distance services for resale to customers in North Carolina, Michigan, and Texas. It pays Sprint roughly 1.5 cents per minute for each call, Mr. Binford said. But after Bell Atlantic completes its merger with NYNEX, "the POP [point of presence]-to-POP costs will be materially smaller." NYNEX also leases Sprint's long distance service; it has signed a contract for Sprint to carry in-region long distance calls when NYNEX is allowed to enter that market.

AT&T's BILLING

AT&T Corp. has launched a new service platform providing business customers consolidated billing and customer service. The platform, called "AT&T.ALL," allows customers to change their choice of services at any time without changing calling plans, AT&T said.

The program includes cellular, long distance, local exchange, messaging, local toll, Internet access, calling card, and "500 Easy-Reach" service. It will be expanded as new business services are offered, AT&T said.

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MCI BEGINS 'MINOR' RESTRUCTURING; HUNDREDS AFFECTED

MCI Communications Corp. has joined the growing number of telecom companies tightening their belts to prepare for a more fiercely competitive environment. A company spokesman confirmed last week that MCI's Mass Markets Division is undergoing a "minor restructuring" that involves a "few hundred" workers at 32 call centers nationwide. But he said the number of affected workers will be far less than the 500 figure cited in some press reports.

The call centers provide sales and support services to residential long distance customers. Affected workers—all nonunion—include sales personnel, managers, telemarketers, and customer service representatives, the spokesman said. Some workers are being reassigned, others are being offered severance packages, and some can choose between those options. The severance package terms weren't disclosed, but the spokesman described them as "generous" and based on length of service.

Bell Atlantic estimates that it will cost \$250 million to build a long distance network in its mid-Atlantic region. Once the network is completed, the company would reduce its transport costs on in-region long distance calls "by more than half a penny," Mr. Binford said. He told *TR* that to build a long distance network in NYNEX's region would cost less than "\$250 million." Bell Atlantic intends to complete its network in 1997, about the same time it expects to offer in-region long distance services.

Over last two years "Bell Atlantic product lines have been put in place so that long distance can be plugged in," Mr. Binford said. The company also has been running generic ads with its spokesman, James Earl Jones, projecting Bell Atlantic's "total provider" image. "In every month, well over a million customers ask us about Bell Atlantic long distance service," Mr. Binford said. And when Bell Atlantic has satisfied federal requirements for providing in-region long distance services, "We'll be able to ask, 'Do you use Bell Atlantic for all your long distance needs?'" Mr. Binford expects that Bell Atlantic's telco in Maryland will be the RHC's first to meet requirements of the "competitive checklist" spelled out in section 271 of the Telecommunications Act of 1996. (Checklist requirements must be met before a Bell company provides in-region interLATA services.)

Bell Atlantic also is keeping a close eye on the intraLATA toll market, especially in Pennsylvania and New Jersey, which constitute more than half of Bell Atlantic's \$1.5 billion intraLATA toll franchise. Last month Bell Atlantic introduced a flat-rate pricing plan in New Jersey. In Pennsylvania, it is offering various intraLATA toll discount plans that are offset by hikes in the price of directory assistance and "0+" services.

BellSouth Pumps Up Brand Name

For BellSouth Telecommunications, Inc., new competitive opportunities present new challenges. Test marketing over the last two years showed that BellSouth "wasn't being given credit" for its technological leadership and its high service quality, said Charles B. Coe, Group President-customer operations. Part of the problem involved the consolidation of BellSouth's telco operations under the single brand name used today.

In October 1995, fewer than 30% recognized the "BellSouth" brand name. So it embarked on an aggressive strategy of "brand building." BellSouth's advertising is geared to linking technological innovations with the needs of ordinary people. And like some other Bells', its ad campaigns also have stressed the unique features of its service territory. Today more than 80% of the customers surveyed recognize the brand name. Nevertheless, Mr. Coe said, Bell companies "cannot depend on advertising and marketing alone." They "must deliver on [service] promises every day. Service quality is number one on our list; it should be number one on anyone's list," he said.

For example, the company has succeeded with its "customer-desired due date" provisioning system, which allows customers to decide when to receive the monthly telephone bill. "Everybody loves it," Mr.

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Coe said. And the telco changed its philosophy toward problem-solving by emphasizing "trouble resolution" over "operational efficiency." BellSouth, like most telcos, used to measure its ability to respond to customer problems by how long a department took to pass the problem to another department. "Now we measure how often a problem is resolved after the first customer call," he said.

"Marketing 101 says go after existing customers," Mr. Coe said. That's a good strategy for BellSouth, which serves 22 million access lines and has enjoyed a 20% growth rate in vertical services in the last year. This year Mr. Coe expects BellSouth's vertical service revenues to exceed \$1 billion for the first time. "There is enormous opportunity in vertical services growth when you consider [that] penetration rates [for such services] are low," he said.

But marketing vertical features is tricky, Mr. Coe said. Consumers get "fuzzy" about connecting a technology with a brand name. "From a customer standpoint, being a technology leader is irrelevant. You've got to find a way to make technology marketable." BellSouth was able to use the Olympics to communicate how its technology enabled people all over the world to experience the 1996 Summer Games.

Ameritech Employs 'Product Management' Strategy

Thomas J. Reiman, President-product management at Ameritech Corp., was quick to note, "There are some differences emerging among the Bell companies, and not just in the different advertising companies we use. If you focus only on gaining or losing market share, you miss the big picture." Ameritech, for example, is focused less on market segments and more on products. "Product management has been a nondeveloped discipline in communications. . . We became serious about it four years ago as we began acquiring product managers" from other industries, he said.

Ameritech also has been trying to show how its technology can affect the lives of ordinary Americans. But it has taken that effort farther than other Bell companies. Ameritech operates the "Human Factors" program to test-market its products in small towns. This testing early in the development cycle helps to ensure that Ameritech's products (interactive TV, for example) are easy to use and understand, Mr. Reiman said.

Ameritech has several products under development—a family of voice-recognition products, for example. And Mr. Reiman said there is a "strong" customer need for its Speaker ID, computerized training, national directory assistance, and asynchronous digital subscriber line (ADSL) offerings. He is particularly excited about Speaker ID, which verifies a speaker's voice pattern. The company markets it to law enforcement agencies as a method of monitoring home-incarcerated criminals. In one deal, Ameritech sold the system to a law enforcement agency, which now resells it at a markup to prisoners who want to be incarcerated at home.

Asked what Ameritech has "learned from local competition in Michigan," Mr. Reiman said, "Customers get confused and they don't want to be confused. They got tired of the long distance wars." Competing on price isn't going to attract customers, he added, because pricing systems often are confusing. Regarding other markets, Mr. Reiman said, "Our cable TV experience is wonderful. We compete with cable TV companies that have franchises all over the country, but they go in to do something special only in the markets we're in." Ameritech operates several cable TV companies in Ohio and Illinois and is building its own systems in several states.

Pacific Bell Prepares for Long Distance Fight

Elizabeth A. Fetter, President of the Industry Markets Group at Pacific Bell, highlighted her company's "record year" for wholesale sales that surpassed company projections. The number of new lines served also has bounced back this year: 432,000 between January and June. That's a 400% increase over last year's performance and 150% better than the company's four-year average for the first

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six months in each of those years. She acknowledged that the financial community long has regarded Pacific Bell's parent company, Pacific Telesis Group, as among the weakest RHCs.

Pacific has suffered from a chronically slumping California economy for several years, which it blames in part for its anemic access line growth over the past two years. It also took financial hits when Pacific Telesis spun off its unregulated service unit, AirTouch Communications, Inc., in 1994 and the telco drastically cut switched access rates in 1995. Now those moves are beginning to pay off, said Ms. Fetter. California has the lowest switched access rates in the country, averaging 2 cents to 3 cents a minute. In contrast, Texas has one of the highest rates, nearly 12 cents a minute on average.

Those figures will be very important as the battle for long distance customers heats up next year, Ms. Fetter said. California is a bonanza market for long distance calling. Nearly 25% of all U.S. long distance phone calls originate in the state. And the high volume, she said, makes Pacific Bell a big target for the interexchange carriers because "the stakes are higher." California accounts for an estimated 20% of AT&T's total originating minutes of use, 19% of MCI Telecommunications Corp.'s, 23% of Sprint's, and 17% of WorldCom, Inc's.

Like NYNEX on the other coast, Pacific Telesis is adopting a more defensive strategy to hold on to customers in its local service markets. Pacific "is trying to make resale as attractive as possible" for potential market entrants. That's the best way it can preserve revenue as competition begins, Ms. Fetter said.

She cited "four ways you can serve customers in a competitive environment: (1) a clear sale, in which you retain the customer and provide all the services; (2) resale at, say, a 20% discount [off the retail rate], in which you keep the network traffic; (3) near sale, in which you don't carry the traffic and only sell the link between the customer and the service provider; and (4) no sale." She added, "We're being very aggressive about negotiating with competitive LECs to make resale as attractive as possible and to retain as much revenue share as possible."

SBC Looks To Outflank Competition

James D. Gallenmore, VP-marketing for SBC Communications Corp., noted that his company "makes a big distinction between the rules of engagement and preparing for competition. My job is to be ready to compete, no matter what the rules are." He highlighted Southwestern Bell Telephone Co.'s preemptive moves to block future competitors from gaining a foothold in its local markets.

For instance, "We knew competitors would attack multidwelling units" as a market-entry strategy, Mr. Gallenmore said. So Southwestern Bell started a program three years ago to sign multiyear contracts covering local and long distance access services to big apartment buildings. It now has about 900 complexes under contract, preserving about 200,000 "highly threatened consumers."

Mr. Gallenmore also trumpeted "Local Plus," Southwestern Bell's flat-rate calling plan for intra-LATA toll calls. It plans to roll out the service in its first major market this year—the Dallas/Fort Worth area. Southwestern Bell has taken 12,000 advance orders for the plan through a "limited, highly targeted" marketing campaign that didn't include direct mailings or broadcast advertising, he said. That experience has led SBC to say, "Yes, we are believers in flat-rate long distance services," he remarked.

Like most other Bells, Southwestern Bell is concentrating on target marketing to take advantage of unique populations in its service territory. For example, the company serves many Hispanic customers. If the planned merger with Pacific Telesis takes place, the new company would serve 25% to 50% of the total U.S. Hispanic population—a group with high rates of international calling, Mr. Gallenmore noted. Southwestern Bell is targeting this population, as well as "busy households and campus populations." These customers represent a natural advantage for Southwestern Bell, he said. □